

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

RECEIVED

JUL 27 1993

In the Matter of)

1993 Annual Access Tariff Filings)
GTE Telephone Operating Companies)
GTE System Telephone Companies)

93-193 /
CC Docket No. 93-193
Transmittal No. 781
Transmittal No. 38

National Exchange Carrier Association)
Universal Service Fund and Lifeline)
Assistance Rates)

CC Docket No. 93-123

GSF Order Compliance Filings)
GTE Telephone Operating Companies)
GTE System Telephone Companies)

Transmittal No. 796
Transmittal No. 48

Bell Operating Companies' Tariff for 800)
Service Management System and 800 Data)
Access Tariffs)

CC Docket No. 93-129

DIRECT CASE OF GTE

GTE SERVICE CORPORATION AND
ITS AFFILIATED GTE DOMESTIC
TELEPHONE OPERATING
COMPANIES

Gail L. Polivy
1850 M Street, N.W.
Suite 1200
Washington, D.C. 20036
(202) 463-5214

Richard McKenna, HQE03J36
GTE Service Corporations
P.O.Box 152092
Irving, TX 75015-2092
(214) 718-6362

July 27, 1993

THEIR ATTORNEYS

No. of Copies rec'd
List A B C D E

047

TABLE OF CONTENTS

	Page
SUMMARY	iv
BACKGROUND	1
Issue 1	3
1. Introduction.....	3
2. GTE has carried the burden of demonstrating that the TBO represents costs triggered by administrative action beyond their control.	5
3. The OPEBs costs are not fully included in the price cap formula via the GNP Price Index (GNP-PI).....	14
a. SFAS-106 will have a small impact on GNP-PI.	15
b. SFAS-106 has a disproportionate impact on LECs.	16
c. The extreme conservatism of the Godwins study justifies reliance on its results.	16
4. Exogenous treatment will not result in double-counting.	18
a. GTE's filings and future filings eliminate any possible intertemporal double-counting.	19
b. SFAS-106 costs are not included in the ROR.....	19
c. Double-counting does not exist as a result of the productivity study.	20
5. Exogenous treatment should be granted for the TBO and related components of OPEBs.	20
6. GTE provides the required actuarial data in response to paragraph 105 of the Designation Order.....	21
7. GTE furnishes the pertinent section of employee handbooks, union contracts, and other items in response to paragraph 105 of the Designation Order.	22

Issue 2.....	23
1. Introduction.....	23
2. The reasonableness of the calculation used in the Annual Filing must be based upon the price cap rules already adopted, not a future proceeding.	23
3. Prior year's sharing and low-end adjustments should not be used in computing rates of return for determination of the current year's sharing or low-end adjustments.	25
Issue 6.....	30
1. Introduction.....	30
2. The General Support Facility cost reallocations are correct as filed.	31
Issue 7.....	31
1. Introduction.....	31
2. LIDB query charges should be included in the traffic sensitive basket since the costs associated with LIDB are part of the tandem access costs which are in the transport category.....	32

SUMMARY

This Direct Case is submitted in response to the Commission's investigation of issues arising out of the 1993 Annual Access tariff filings.

GTE shows that it has carried its burden of demonstrating that Transitional Benefit Amounts ("TBO") represents costs triggered by administrative action, beyond GTE's control. Thus, exogenous treatment is justified for the TBO and related components of OPEBs. In addition, GTE provides the pertinent sections of employee handbooks, union contracts and other items in response to the Commission's request.

In addition, GTE shows that prior year's sharing and low-end adjustments should not be used in computing rates of return for determining the current year's sharing or low-end adjustments.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

RECEIVED

JUL 27 1993

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of)	
)	
1993 Annual Access Tariff Filings)	CC Docket No. 93-193
GTE Telephone Operating Companies)	Transmittal No. 781
GTE System Telephone Companies)	Transmittal No. 38
)	
National Exchange Carrier Association)	
Universal Service Fund and Lifeline)	CC Docket No. 93-123
Assistance Rates)	
)	
GSF Order Compliance Filings)	
GTE Telephone Operating Companies)	Transmittal No. 796
GTE System Telephone Companies)	Transmittal No. 48
)	
Bell Operating Companies' Tariff for 800)	CC Docket No. 93-129
Service Management System and 800 Data)	
Access Tariffs)	
)	

DIRECT CASE OF GTE

GTE Service Corporation, on behalf of its GTE affiliated domestic Telephone Operating Companies (the "GTOCs") and the GTE System Telephone Companies (the "GSTCs") (collectively, "GTE"), hereby submits this Direct Case in response to issues designated for investigation in the Commission's Memorandum Opinion and Order Suspending Rates and Designating Issues for Investigation, DA 93-762, released June 23, 1993 ("Designation Order").

BACKGROUND

On April 2, 1993, GTE submitted the 1993 Annual Access Tariff filings to adjust the price cap indices for each basket based upon the GDP-PI and relevant exogenous changes, and to include new services initiated in the prior calendar year, earning

adjustments and productivity offsets.¹ GTE filed revised tariff rates on June 17, 1993 to reflect reallocation of certain of General Support Facilities ("GSF") costs in compliance with the GSF Order.² The revised rates were to be effective July 1, 1993.

On June 23, 1993, the Commission released the Designation Order which suspended the rates proposed in the April 2 Annual Filing and the GSF Filings for one day, and allowed the rates to go into effect under an accounting order. The Designation Order also established eight issues for investigation. Only four of these apply to GTE. The following issues will be addressed in this Direct Case:

1. Transitional Benefit Obligation ("TBO") as an exogenous cost. TBO costs are costs incurred by price cap Local Exchange Carriers ("LECs") in conjunction with Other Post-Retirement Employee Benefits ("OPEBs"). The LECs are directed to provide evidence of, and describe the following, as presented by their actuaries and used by the LECs to compute OPEB amounts claimed in their annual filings:

- a. the ranges of data on the age of the work force;
- b. the ages at which employees will retire;
- c. the length of service of retirees;

LECs are to provide pertinent sections of their employee handbooks, contracts with unions, and other items that include statements to the employees concerning the company's ability to modify the post-retirement benefits package.

2. Calculation of Sharing and Low End Adjustments. LECs are to address how amounts from prior year adjustments should be reflected in computing the rate of return for the current year's adjustments to the price cap indices.

¹ See GTOC Transmittal No. 781 and GSTC Transmittal No. 38.

² Amendment of the Part 69 Allocation of General Support Facility Costs, CC Docket No. 92-222, Report and Order (FCC 93-238) released May 19, 1993 (GSF Order). See GTOC Transmittal No. 796 and GSTC Transmittal No. 48 filed June 17, 1993. (GSF Filings)

3. General Support Facility cost allocations. LECs are to show that the changes in the GSF costs been properly reallocated.

4. Line Information Database ("LIDB") query charge assignment to price cap basket. LECs are to show that charges for this new service have been assigned to the proper basket.

GTE will show herein that the treatment of exogenous costs, and the methodology used in development of costs underlying the proposed rates, comply with the Commission's rules and policies and are just and reasonable.

Issue 1: Have the LECs borne their burden of demonstrating that implementing SFAS-106 results in an exogenous cost change for the TBO amounts under the Commission's price cap rules?

1. Introduction

For fiscal years beginning after December 15, 1992, the Financial Standards Accounting Board ("FASB") prescribed that its Statement of Financial Accounting Standards 106 ("SFAS-106") would be effective. SFAS-106 recognizes Other Post-Retirement Benefits ("OPEBs") as a form of deferred compensation earned by employees as they furnish service to their employer. Recognition of OPEBs over the relevant employee service period is accomplished under the principles of accrual accounting.

In December 1991, the Common Carrier Bureau approved the request of GTE Service Corporation and Southwestern Bell to adopt SFAS-106 accounting for OPEBs on or before January 1, 1993.³ The SFAS-106 Adoption Order authorized all subject

³ Southwestern Bell Corporation, GTE Service Corporation, Notification of Intent to Adopt Statement of [SFAS-106], 6 FCC Rcd 7560 (CCB, 1991) (SFAS-106 Adoption Order).

carriers to adopt SFAS-106 accounting on or before January 1, 1993, using the amortization method of recognizing the transition obligation.⁴

In April 1992 the Suspension and Investigation Order⁵ suspended tariff filings of Bell Atlantic and US West and designated for investigation issues arising from the claim of these LECs that the incremental change in accounting cost resulting from SFAS-106 should be treated as a one-time exogenous cost change under price caps.⁶ All LECs subject to price caps were designated as parties to the investigation.

In January 1993, the Commission decided⁷ that the LECs subject to price caps "have not met their burden of demonstrating that implementation of SFAS-106 should be considered an exogenous cost change under the Commission's price cap rules."⁸ While finding the tariff filings unlawful, the Commission did not "foreclose these carriers or others from making a more persuasive showing in the context of the 1993 annual access tariff filings."⁹ Specifically leaving the door open for further review of whether

⁴ Id. See also: Uniform Accounting for Post-Retirement Benefits Other Than Pensions in Part 32 (May 4, 1992), 7 FCC Rcd 2872 (1992) (RAO Letter 20).

⁵ Treatment of Local Exchange Carrier Tariffs Implementing [SFAS-106], CC Docket No. 92-101, 7 FCC Rcd 2724 (CCB, 1992) (Suspension and Investigation Order).

⁶ For the Commission's price cap program, see Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, CC Docket No. 87-313, 5 FCC Rcd 6786 (1990) and Erratum, 5 FCC Rcd 7664 (1990) (LEC Price Cap Order), modified on recon., 6 FCC Rcd 2637 (1991) (LEC Reconsideration Order), aff'd. sub nom. National Rural Telecom Association v. F.C.C., 988 F.2d 174 (D.C. Cir. 1993).

⁷ Memorandum Opinion and Order, CC Docket 92-101, 8 FCC Rcd 1024 (1993), petition for review pending, No. 93-1168 (D.C. Cir. February 19, 1993) (QPEB Order).

⁸ Id. at 1024-25.

⁹ Id., 1025.

exogenous treatment should be accorded to the Transitional Benefit Obligation ("TBO"), *i.e.*, the unfunded obligation for OPEBs to retirees and active employees existing as of the date of adoption of SFAS-106, the OPEB Order said: "Our decision in this case is not intended to foreclose further consideration of exogenous treatment of TBO amounts...."¹⁰

2. GTE has carried the burden of demonstrating that the TBO represents costs triggered by administrative action beyond their control.

The Commission defines exogenous costs as "those costs that are triggered by administrative, legislative, or judicial action beyond the control of the carriers."¹¹ Specifically identified in the Price Cap Order as "costs that should result in an adjustment to the cap in order to ensure that the price cap formula does not lead to unreasonably high or unreasonably low rates," were "costs [that] are created by such events as ... USOA amendments...."¹² Even more specifically, under "USOA amendments; GAAP changes", the Price Cap Order said:

168. Changes in LEC costs that are caused by changes in Part 32 of our Rules, the Uniform System of Accounts (USOA), will be considered exogenous. We make this classification on the basis that such changes are imposed by this Commission and are outside the control of carriers. However, carriers are not authorized to adjust their price caps automatically to reflect changes in generally accepted accounting principles (GAAP).... [C]ertain GAAP changes may require amendment to the USOA while others may not. Carriers must notify us of their intention to apply a change in GAAP and we will allow such change if we find it to be compatible with our

¹⁰ Id. at 1037.

¹¹ LEC Price Cap Order, 5 FCC Rcd at 6807.

¹² Id., footnote omitted.

regulatory accounting needs. No carrier may adjust its price caps to reflect a change in GAAP until we have approved the carrier's proposed change. Furthermore, we wish to clarify that no GAAP change can be given exogenous treatment until the Financial Accounting Standards Board has actually approved the change and it has become effective. The cap mechanism is intended to reflect changes in costs that have occurred, not anticipated cost changes.¹³

The Price Cap Order, as reflected in the foregoing words, contemplated the grant of exogenous treatment for costs **triggered** by government action. The word "trigger" is a metaphor. The primary meanings of "trigger" have been defined¹⁴ as: (1) "The lever pressed by the finger to discharge a firearm." (2) "Any similar device used to release or activate a mechanism." As a noun, used in a metaphoric sense, it has come to develop the third meaning: "An event that precipitates others; a stimulus." And, by the same metaphor, the verb "trigger" has come to mean to "initiate; activate; set off."¹⁵

In its original sense, a "trigger" assumed a preexisting explosive charge which was set off (triggered) by pressing the lever (trigger) or activating a mechanism. The metaphoric use of the word conveys the same meaning. To trigger a celebration,¹⁶ for example, suggests the triggering event releases elements that existed independently, just as pulling a trigger activates the mechanism that causes an explosive charge to detonate. This use of this word in the Price Cap Order ("costs ... triggered by administrative ... action") comports with this meaning. It assumes government action

¹³ Id., footnotes omitted.

¹⁴ The American Heritage Dictionary of the English Language (1981 edition).

¹⁵ Id. "Usage: *Trigger* (verb), in earlier usage largely restricted to the literal sense of pressing a trigger, is now chiefly employed in the figurative sense of initiating or setting off something such as a celebration...."

¹⁶ Id.

that activates a particular result just as a trigger activates an explosive charge. The FCC specified that the underlying change in GAAP mandated by FASB does not justify price cap adjustments; these adjustments are triggered by the Commission's action allowing the accounting change upon its finding that the accounting change is compatible with its regulatory accounting needs.

The facts involving OPEBs come right within the Commission's specification. The triggering action – activation of the SFAS-106 accounting requirement by the Commission's approval – represents administrative action that is totally beyond the control of the LECs.

But the OPEB Order in January 1993 took a dramatically different approach. The clear indication in the Price Cap Order in the words quoted *supra*, at the beginning of the process, was that exogenous treatment would be granted if four conditions are met: (i) actual issuance of a FASB requirement, (ii) notice by the companies to the Commission, (iii) a Commission finding of compatibility with its regulatory accounting needs, and (iv) Commission authorization of the accounting change. This clear indication appears to be put aside by the OPEB Order.

As frankly acknowledged by the OPEB Order, the Commission made a later change in its interpretation: "We were initially inclined to treat accounting changes as categorically exogenous. This included GAAP changes, if the Commission found the changes in GAAP consistent with our regulatory accounting needs, and the change had become effective. However, we later ... decided to consider GAAP changes on a case-by-case basis."¹⁷

The standard established by rulemaking is set out in plain English: There will be exogenous treatment of costs "triggered by administrative, legislative, or judicial action beyond the control of the carriers." The triggering "action" in question is governmental -

¹⁷ OPEB Order, 8 FCC Rcd at 1032.

- which is reinforced by words specifically relating it to the three branches of government: administrative, legislative or judicial. The Commission's own language stressed that there had to be an effective FASB requirement that was approved by the Commission. The clear import of the words is that, when the FASB requirement is effective and the Commission issues its approval, exogenous treatment will be granted provided the administrative, legislative or judicial action is not under the control of the LEC. No one can suggest the action of the Commission (or even the combined action of the FASB and the Commission) was under the control of GTE. Thus, all the events, all the conditions the Commission attached to a grant of exogenous treatment have occurred.

Nonetheless, the OPEB Order denies exogenous treatment on the basis of an understanding of the exogenous principle not even hinted at in the Commission's rule, in the LEC Price Cap Order, or in the Price Cap Reconsideration Order. Under this new understanding, "a lack of control over the regulatory action is not enough of a showing to justify exogenous treatment."¹⁸ Now there is a new theory:

[W]e find that the LECs have had, and continue to have, control over the present and future benefit plans they set with their employees and the costs of these plans, the major determinants of OPEB expenses. Just as they do for depreciation expense, LECs can exercise substantial control over the level and timing of OPEB expenses. Treating a change in OPEB accounting as exogenous would, at least for ongoing benefit plans, give the LECs undue power to influence their PCI levels, and would undermine the incentive structure of price caps.¹⁹

¹⁸ Id. at 1033.

¹⁹ Id.

Now the shape and substance of the rule is completely different. It is not a question of whether the governmental action is under the control of the carrier; it is whether the carrier controls the circumstances that underlie the governmental action.

The cited precedent for this decision is the Commission's "decision to deny exogenous treatment of depreciation rates."²⁰ In doing so:

[T]he Commission noted that while the change in depreciation rates was set by federal and state regulatory agencies and was thus beyond the control of the carriers, the carriers nonetheless could exercise control over depreciation costs through their decisions to deploy or retire equipment, the major determinant of the amount of depreciation expenses.

This means that there are two sets of distinctions between the decision to deny exogenous treatment for OPEBs and the decision to deny exogenous treatment for depreciation.

First: In the case of depreciation the denial of exogenous treatment was

Second: The stated Commission concern underlying its decision in the LEC Price Cap Order was that, in the case of depreciation, "the carriers ... could exercise control over depreciation costs through their decisions to deploy or retire equipment, the major determinant of the amount of depreciation expenses." When the decision is made by an exchange carrier to retire a particular piece of equipment and (typically) replace it with another item, this process is carried out entirely within the exchange carrier itself. A single enterprise within itself makes the investment decision, removes the old equipment, installs the new equipment, provides service by employment of that new equipment, proposes to state and/or federal authorities depreciation treatment, and then implements depreciation as permitted or required by those authorities. In terms of what the Commission considered the driver of the whole process ("the major determinant of the amount of depreciation expenses"), *i.e.*, the investment/procurement decision, the exchange carrier is its own vendor, its own purchaser; **no outside party is involved.**

In the case of OPEBs, the fundamental situation is worlds apart. What is involved is a series of transactions between the company and its employees starting with initial hiring and running through retirement typically until the employee's separation or death. Part of these transactions involves furnishing medical benefits to present and retired employees of the company. It is not a question of the company being both vendor and customer; the "customers" that receive the benefit are individuals on their own account; and that benefit is a consequence of a complex and long-standing arms length business relationship. **The process does not occur entirely within the company; it cannot be controlled by the company in any sense analogous to the investment/procurement process the Commission considers key to depreciation decisions.**

This point is proved by two illustrations. Suppose the company fails to make a timely replacement of a piece of equipment. As the old equipment proves inadequate,

various parts of the company itself might be "hurt." Operations might have to incur overtime costs, Engineering might incur costs working out temporary solutions, and so forth. But the untimely investment decision has no direct impact on any party to the transaction outside the company itself. As a contrasting illustration, suppose the company does either one of two things. The company: (i) decides to eliminate OPEBs entirely effective next January 1 (the "*Elimination Scenario*"); or (ii) decides to adopt measures that in effect reduce the benefit of OPEBs for retired employees by fifty percent next January 1 (the "*Fifty Percent Scenario*").

Under either the *Elimination Scenario* or the *Fifty Percent Scenario*, it is not merely a question of one part of the company being hurt by another part of the company. Thousands of employees – in terms of benefits now being received, or in terms of those benefits they would expect to receive in the future – would be parties to the transaction and directly affected.

Under either scenario, the matter of OPEBs would – putting it mildly – become instantaneously a subject of collective bargaining. The consequent reaction of employees and labor unions would be as solid a fact as exists anywhere. These developments would be likely to impose substantial explicit and implicit costs on the company beyond any ability of the company to exercise control.

Under either scenario, the consequences for the company would affect all aspects of its business. If GTE adopted either the *Elimination Scenario* or the *Fifty Percent Scenario*, there would be a very real impact on the companies' ability to hire and retain the number and quality of employees required to conduct GTE's complex and challenging business. The employee's trust in the company – his or her willingness to commit a working lifetime in the expectation of fair treatment – is a real world factor that has a direct and important bearing on whether an employee will continue with the company. A company's reputation for fair treatment has a direct and

important bearing on whether the best qualified people will be willing to become company employees in the first place.

This discussion reflects the reality that what is involved in OPEBs does not come within the scope of the stated concerns of the Commission in the case of depreciation. It is not a matter of transactions entirely within the company, and consequently entirely within the company's control. All transactions involving OPEBs involve parties independent of the corporation; all such transactions are two-sided in their impact and in their implications for the company.

The factors discussed *supra* impose important and real limitations on the company's freedom of action. The effect of these limitations on GTE's ability to exercise "control" is no less real where there is no legally binding obligation in the sense of legislation or court orders or collective bargaining agreements. In the real world, companies must contend with a vast range of constraints that are no less effective in compelling action than contractual commitments or statutes or court/agency orders. To assume total freedom of action on the part of the company – and therefore "control" – merely because there is not a relevant legally binding commitment would empty the exogenous rule of all meaning because there will never arise a case where there is not some possibility, by some far-fetched or absurd scenario, of company management taking different action. It would similarly negate the exogenous rule to deny completely exogenous treatment of the TBO, in the spirit of the OPEB Order, based on the theoretical possibility of either the *Elimination Scenario* or the *Fifty Percent Scenario* – two scenarios that if implemented would guarantee corporate disaster in human relations terms, with consequent inability of the company to meet its commitments to its customers, its regulators and the public.

GTE is actively addressing OPEBs costs just as it is seeking to reduce other costs in a competitive environment. The fact that such efforts continue does not mean that management control exists in the sense of the exogenous rule. GTE is faced with

an absolute need to attract and retain quality employees. Denial of exogenous treatment for the TBO amounts to the assumption that GTE is free to adopt not just the *Fifty Percent Scenario* but the *Elimination Scenario*, and essentially penalizes GTE for not doing so.

Further, the complete denial of exogenous treatment for the TBO would amount to adopting the assumption that any trace of control requires complete denial. Nothing in the development of the price cap program suggests the exogenous standard was intended to preclude *any element* of management control. If this were the case, no situation would ever be likely to arise in which exogenous treatment would be justified.

The issue before the Commission is the accounting change which was a one-time event triggered by government action. This event was not under management's control, and it is from this event that the need for exogenous treatment arises. Subsequent actions that the company may take to make adjustments to the plan do not negate the fact that the accounting change is triggered by administrative action as contemplated by the Commission's rule.

Recognizing doubts on the part of the Commission as to how the question of management control can be quantified and evaluated in realistic terms, GTE has made a "true-up" proposal. Under this proposal, any decrease in the TBO and associated net periodic costs, regardless of the cause, would be reflected in future annual price cap filings as an adjustment to the exogenous amount granted by the FCC. This methodology requires GTE to bear the risk of any increase in the TBO, thereby protecting the ratepayer's interest. Any decrease in the TBO would be passed through to the benefit of the ratepayer. This true up would adequately address the Commission's concerns regarding arguments that management controls the effects of the implementation of SFAS-106.

In summary: The TBO represents costs triggered by administrative action beyond the control of GTE within the meaning of the Commission's rule, and so is entitled to exogenous treatment, subject to the terms of GTE's true up proposal.

3. The OPEBs costs are not fully included in the price cap formula via the GNP Price Index (GNP-PI).

The Commission has indicated that it will evaluate GAAP changes on a case-by-case basis to determine the eligibility for exogenous treatment, as discussed previously. In determining this eligibility the Commission identified a two prong test.²¹ The first test has been met since the costs have been demonstrated to be outside the control of the Company. The second test has also been met because **84.8% of the costs are not reflected in the price cap formula** as demonstrated by the Godwins study.²²

GTE actively participated in support of the United States Telephone Association

the impact of SFAS-106 on an average price cap exchange carrier's costs versus the impact on costs of an average employer in the United States economy. The macroeconomic analysis analyzed the impact of SFAS-106 on the total economy and the average employer's SFAS-106 costs expected to be passed through to GNP-PI. In particular, the Godwins study establishes the following:

a. SFAS-106 will have a small impact on GNP-PI.

The Godwins study shows in its macroeconomic analysis that the adoption of SFAS-106 will have a very small impact on the GNP-PI used for price caps and this impact will be taken into account by GTE in their tariff filings, so that no double-counting will occur. Godwins found that the increase in GNP-PI caused by SFAS-106 will provide for recovery of only 0.7% of the additional costs incurred by price cap exchange carriers. This is based on (i) the macroeconomic analysis finding that only 2.3% of the incremental SFAS-106 costs of the entire United States economy will be passed through to GNP-PI, combined with the fact, discussed further *infra* that (ii) because of the difference in benefit levels between the economy in total and the price cap exchange carriers, the 2.3% results in only 0.7% of the price cap exchange carriers' SFAS-106 costs increase being reflected in the GNP-PI. In addition, Godwins found that the national wage rate would eventually be 0.93% lower than it would have been without SFAS-106. Godwins concluded that, if price cap exchange carriers were able to benefit from a similar reduction in wage rates, an additional 14.5% of the price cap exchange carriers' SFAS-106 costs would be recovered. Because of the expected national wage rate reduction, GTE accepts this conclusion and does not seek exogenous recovery on 14.5% of its incremental SFAS-106 costs.

b. SFAS-106 has a disproportionate impact on LECs.

The Godwins study shows a disproportionate impact of SFAS-106 on price cap exchange carriers compared to employers generally. Specifically, it demonstrates that only about 28.3% of the cost burden of SFAS-106 experienced by the average price cap exchange carrier will be similarly experienced by the average United States company. This stems from the fact that 73.2% of employees work for companies that do not provide retiree medical benefits, while all the price cap exchange carriers provide such benefits. The obvious conclusion which can be derived from this fact is that even if every company's SFAS-106 costs resulted in direct and full price increases

weakness but a strength in terms of showing the exchange carriers' entitlement to exogenous cost recovery.

Further, the additional sensitivity analysis provides the necessary information requested by the Commission to verify independently the Godwins assumptions and should promote an understanding of the 84.8 percent adjustment. GTE, in using the 84.8 percent factor, took the most conservative approach rather than use the best estimate of 87.3 percent. As noted, the corroboration of assumptions results in the best estimate adjustment of 87.3 percent which is higher than the adjustment GTE had requested.

The Godwins study provides a basis for choosing the lowest value of the range of reasonable values for the extent of SFAS-106 costs not reflected in GNP-PI. It does not provide a justification for choosing zero, which is entirely outside the range of plausible values. The approach used by Godwins is so conservative that the Commission should in good faith rely on the results of the original Godwins study. It is very significant that the California commission has already reviewed both the Godwins and the NERA studies and has concluded that the Godwins study produces a very conservative result.²³

If the Godwins model assumed the TBO would not translate to a price increase for nonregulated firms, then the TBO would not be reflected in the GNP-PI at all. **This would make our Godwins adjustment of 84.8% even more conservative.** Such an assumption reinforces GTE's position that the conscious understatement of the amount for which price cap LECs should be entitled to exogenous cost recovery in the Godwins study is so great that the Commission can with perfect safety rely on its results.

²³ Public Utilities Commission of the State of California, Decision 92-12-015, December 3, 1992, at 56.

Furthermore, GTE propose to eliminate any remaining concerns in this area by completing annual true ups to the exogenous amount the Commission may approve as a result of this filing. GTE proposes that any decrease in the TBO and associated net periodic costs, regardless of the cause, will be reflected in future annual price cap filings as an adjustment to the exogenous amount granted in this filing. This true up would adequately address the Commission's concerns regarding differences in the basic assumptions used for SFAS-106 calculations and the actual experience realized. Since GTE will not request exogenous treatment for any increases in TBO costs, this will further protect the ratepayer.

In summary: The extreme conservatism of the Godwins study makes it still more reliable.

4. Exogenous treatment will not result in double-counting.

The purpose of the Godwins study was to determine the level of OPEBs costs which will be in the GNP-PI. Once identified these amounts were excluded from exogenous treatment and therefore not double-counted. The Godwins study provided reliable and conservative results. The Commission has confirmed this with their statement in the Designation Order²⁴ - "[t]he record concerning double counting in the GNP-PI has been enhanced by a second Godwins study." The removal of the 0.7% GNP-PI impact and the 14.5% expected wage reduction are both based on the conservative Godwins model, and this precludes any double-counting of OPEBs cost. GTE's proposal to complete annual true-ups to the TBO further substantiates that exogenous treatment will not result in double-counting.

Other double-counting issues will be addressed as outlined in the following:

²⁴ Designation Order at paragraph 29.

- a. GTE's filings and future filings eliminate any possible intertemporal double-counting.

The OPEB Order²⁵ says that intertemporal double-counting may occur because pay-as-you-go amounts for OPEBs are already built into rates, so that the GNP-PI-X factor in the PCIs will give the LECs the recovery required over time.

GTE maintains that intertemporal double-counting does not exist. The exogenous adjustment is the difference between the SFAS-106 TBO plus associated net periodic costs and pay-as-you-go costs. To the extent trend rates, as an example, are less than expected the cash and SFAS-106 costs will both be less than expected. The resulting variance if any may not be material. Any difference between actual and expected experience will not directly impact the following year's SFAS-106 accruals. The differences between actual and expected experience will give rise to actuarial gains and losses, the recognition of which is deferred (in some cases indefinitely) because of the corridor approach and amortization rules of SFAS-106. In any case, any arguable double-counting will be more than offset by GTE's proposed annual true-up for any decreases in the TBO and associated net periodic costs.

- b. SFAS-106 costs are not included in the ROR.

At the time of the rate of return represcription, the indications were that SFAS-106 costs would be treated exogenously as reflected in the AT&T Price Cap Order²⁶ and the LEC Price Cap Order.²⁷ With the impression that SFAS-106 costs would be

²⁵ OPEB Order, 8 FCC Rcd at 1035.

²⁶ Report and Order and Second Further Notice of Proposed Rulemaking, CC Docket 87-313, 4 FCC Rcd 2873, 3002-3021 (1989) (AT&T Price Cap Order), on recon., 6 FCC Rcd 665 (1991).

²⁷ Price Cap Order, 5 FCC Rcd at 6807.

treated exogenously, investors had no reason to expect LEC earnings to be depressed by SFAS-106 costs. These costs would be expected to be recovered as any other real and legitimate cost of service and thus have no impact on a regulated utility's stock and consequently are not reflected in the rate of return.

c. Double-counting does not exist as a result of the productivity study.

The Commission claims the productivity studies to determine the productivity factor in the price cap formula resulted in double-counting costs as certain LECs had begun making contributions to Voluntary Employee Beneficiary Associations ("VEBAs") which would have been included in the costs. The Commission concluded this would result in VEBA contributions being counted twice.²⁸ This is an erroneous assumption as the exogenous treatment is only requested on the incremental costs resulting from SFAS-106 and not the total SFAS-106 costs, *i.e.*, the difference between SFAS-106 accruals and pay-as-you-go costs including the aforementioned VEBA contributions.

In summary: Exogenous treatment of TBO costs should be granted because these costs are not reflected in the price cap formula and therefore meet the second prong of the Commission's two-prong test.²⁹

5. Exogenous treatment should be granted for the TBO and related components of OPEBs.

The change from cash to accrual accounting does represent a real cost for GTE. Cash outlays for payment of existing claims will not change but annual expense to be recognized for financial reporting will increase. There is no change in the fact that

²⁸ OPEB Order, 8 FCC Rcd at 1036.

²⁹ Id. at 1033.

these costs are still a reasonable and necessary cost incurred in the provisioning of telephone service. OPEBs costs are similar to other benefit expenses incurred by GTE and should receive similar ratemaking treatment. To accomplish this, exogenous treatment must be granted for at least the TBO and related components of OPEBs.

To allay Commission concerns over possible double counting, GTE proposes the annual true up to the TBO. This means any decrease in the TBO and associated net periodic costs, regardless of the cause, be reflected in future annual price cap filings as an adjustment to the exogenous amount granted in this filing. This methodology requires GTE to bear the risk of any increase in the TBO, thereby protecting the ratepayer's interest. As a part of the annual true up mechanism, GTE recommends that the GNP-PI minus productivity impact on the annual amortized TBO amount be subtracted each year.

The proposed annual true up would maintain the principles of, and is consistent with, the concept of incentive regulation because it maintains the incentives built into the price cap plan. The annual true up is simply a matter of subtracting the original exogenous adjustment granted in this filing from a newly calculated exogenous adjustment resulting in the "z" factor adjustment. This is administratively simple for the carriers and the Commission and complies with the goal of an administratively simpler and less burdensome form of regulation. As such, the concerns with intertemporal doubling counting are sufficiently mitigated.

In summary: The Commission should provide for exogenous treatment for the TBO and related components of OPEBs inasmuch as they constitute a reasonable and necessary cost coming within the exogenous definition, it will not be unduly complex to implement, and any concerns can be offset by GTE's true up proposal.

6. GTE provides the required actuarial data in response to paragraph 105 of the Designation Order.